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¶1. Summary: While the world financial crisis continues, the Turkish banking sector is relatively robust thanks to its strong balance sheets and limited foreign exposure. The Banking Regulation and Supervision Agency (BRSA) is confident about the financial position of the sector, and says bankers continue to watch global risks to minimize negative impacts. Bankers, financial experts, and BRSA told us that Turkey is benefiting from structural reforms implemented following banking and liquidity crises in 2001. BRSA does not foresee major short term impacts, but expects medium and long term harm if defaults increase as the economy slows and interest rates climb as global credit remains tight. In its first direct response to the impact of the global crisis in Turkey, on October 9 the Central Bank announced it will act as a broker in the Foreign Exchange Depot Market to ensure that banks can borrow and lend to one another without default risk. This action will facilitate trades in the foreign currency market to avoid liquidity shortages. Time will tell to what extent the global financial crisis will affect Turkey, but follow-on economic effects look to be the biggest risks. End summary.

Sticking to the Basics Pays Off for All Banks in Turkey

¶2. Since 2001, the Turkish banking sector has improved significantly through economic and structural reforms and the creation of the watchdog Banking Regulation and Supervision Agency. In a difficult global financial environment, Turkish banks have protected themselves by sticking to the basics and not having an extensive mortgage system. Banks Union President and Is Bank CEO Ersin Ozince said on October 8 that the sector is lucky to face economic challenges at a time when the sector is strong, but added that increases in the cost of borrowing will be inevitable. State-owned Halk Bank's CEO Huseyin Aydin said on October 7 that there was not excessive exchange rate or interest rate risk in the sector in general, and any credit risk that may come from small and medium companies should be minor.

View from the Regulator

¶3. BRSA Vice President Sabri Davaz told us on October 8 that Turkish banks do not have liquidity problems and currently maintain a capital adequacy ratio of 17%, which is well above the required level of 12%. Davaz told us even though banks are spending more to get access to capital because of higher

risks globally and domestically, they have not had difficulty rolling over their foreign exchange loans in the past months. He noted that the debt of the private sector creates an ongoing risk for the economy overall. Davaz listed the main banking risks as maturity mismatch (deposits of three months or less and loans of one year or more); a slow down in economic growth; outstanding debt of the private sector (Central Bank and Banks Union estimate the debt at around $70 billion in 2008 and think it will top $100 billion in 2009); and rapidly-changing interest rates. Davaz also noted that even though they do not expect a major short-term impact of global conditions on the banking sector, BRSA expects the number of non-performing loans to increase due to contraction in the economy.

¶4. A Banks Union report shows the number of non-performing consumer loans increased in the second quarter of 2008, even while the volume of loans increased. Consumer loan volume grew 17.4% in the first half of the year. During periods of rising interest rates, consumer loans are often the first harbinger of a change in sentiment, and bankers expect demand for these loans to slow. According to BRSA, as of October 2008 the overall sector loans-to-deposit ratio is still at 87.3%. Deposits of up to YTL 50,000 ($37,000) are under the deposit insurance guarantee in Turkey. Leading business daily Referans called for the GOT to raise this limit to keep deposits in Turkish banks. Former Central Bank Governor Ercin Kumcu and other business leaders have echoed the call for higher insurance limits.

Central Bank Facilitates Foreign Currency Trades
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¶5. On October 9, the Central Bank announced it will act as a broker in the Foreign Exchange Depot Market to ensure that banks can borrow and lend to one another. The FX Depot Market will act as intermediary between borrowing and lending banks, and transactions will be collateralized and anonymous. Borrowing periods may extend from one week to one month and will be made in minimum increments of $1 million or one million Euros. According to its official press release, the Bank will continue this role "until uncertainty in international markets ends" to avoid liquidity shortages. This is the Central Bank's first direct response to the impact of the global crisis in Turkey. Central Bank Deputy Director General Emrah Eksi said banks are in good shape overall, although he noted they will have a total of $3 billion in foreign exchange loans to roll over before the end of 2008. The Foreign Exchange Depot Market should make that process easier.

International Interest

¶6. The Turkish banking system has attracted major foreign banks to Turkey through mergers and acquisitions (M&A) in the past five years. Most of these were European banks such as HSBC, Dexia, Fortis, Unicredito and the National Bank of Greece. One of the important M&A's of the sector was Citibank's 2006 purchase of 20% of Akbank--Turkey,s leading commercial bank. The crisis in the U.S. and European banking sectors has raised questions about the position of foreign banks operating in Turkey. BRSA's Davaz is not concerned. He told us that ownership of Fortis Bank's Turkish operations is held exactly like ownership of the parent bank holding company. Seventy percent is held by Banco Nationale Paribas, and 30% is held by the Government of Belgium. BRSA, in its role as regulator and auditor, does not foresee risks for Fortis or other foreign banks operating in Turkey. Sevdil Yildirim from BGC Partners in Istanbul, a U.S. asset management and consulting company, told us October 8 that Gulf countries and investors remain interested in buying Turkish banks and investing in privatizations and other assets as they become available. Regarding the position of Yapi Kredi Bank, co-owned by Unicredito and Koc Holding, and Garanti Bank, co-owned by GE Investment and Dogus Holding, Yildirim noted that both Koc and Dogus have solid cash positions. Ferit Sahenk, main owner of Garanti Bank and CEO of Dogus, said that regulatory and business changes made

since 2001 have made Turkish banks more resilient to shocks.

Comment

¶7. While the Turkish banking sector may be less exposed to global financial risks than that of other countries, there is concern about the follow-on economic effects of a tightening of credit or an increase in consumer or SME loan defaults (septel).

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